BPO PROPERTIES

2003 Annual Report

Front Cover: Bankers Hall, Calgary; Queen's Quay Terminal, Toronto; Fifth Avenue Place, Calgary
Above: Bankers Hall, Calgary

Dear Shareholders,

We look back on 2003 as both a challenging and rewarding year for BPO Properties. Despite soft real estate markets, our strategy of owning premier office properties in the downtown core of select Canadian cities with long-term leases to high-quality tenants has enabled us to deliver on our objectives. We are pleased to share with you our operational and financial highlights for 2003 as well as our strategy for 2004 and beyond.

Financial Results

Our performance in 2003 reflects the merits of our pro-active leasing and asset management strategy, which continues to shield us from a slow leasing environment. BPO Properties achieved $132 million or $4.20 per share of Funds from Operations ("FFO") for the year ended December 31, 2003 compared to $220 million or $7.34 per share in 2002. FFO prior to disposition gains totaled $128 million or $4.07 per share, an increase from 2002 to $124 million or $3.98 per share. The 2002 results included $96 million or $3.36 per share in gains on the dispositions of 50% interests in Exchange Tower in Toronto and Bankers Hall in Calgary.

Investor demand for well-leased, high-quality office properties continues to be strong, with many investors willing to acquire properties at prices not seen in many years. BPO's management team has taken advantage of these strong markets by selling interests in a number of properties for substantial gains over the past two years. As a result, the company's financial position has been strengthened significantly as has its liquid cash position.

Given the company's strong financial position and the difficulty we have encountered in acquiring high-quality assets that meet our return criteria, the Board of Directors declared a special common share dividend of $15 per share, totaling approximately $428 million, payable March 31, 2004 to shareholders of record at the close of business on March 1, 2004. This special dividend is being funded from the company's cash resources. Following payment of the special dividend, the company will have in excess of $400 million in cash and marketable securities to fund future growth.

Operational Achievements

Minimal lease maturities over the next few years, below-market embedded rents and a strong tenant base are the fundamentals upon which we should be able to deliver on our financial and operating targets. Within the current market dynamic, we create value through pro-active leasing and asset management strategies, including the re-leasing of space at higher-than-market rents, opportunistic lease take-backs, and the subsequent disposition of full or partial interests in properties.

Following are the highlights of our 2003 achievements:

- Leased 1.4 million square feet, despite a sluggish leasing environment. Year-end vacancy in our portfolio stands at 3.8% compared to a Canadian national average of 11.6%.
- Issued $37 million second-mortgage bonds on the Petro-Canada Centre in Calgary.
- Completed our strategy of exiting the retail market with the disposition of Merivale Place for $24 million, further strengthening the company's position as a leading office property company in Canada.

- Completed our joint venture commitment with a residential condominium developer on the prestigious retail/condominium development No. 10 Bellair located in the heart of Toronto's Yorkville area. This development provided us with higher-than-planned returns.
- Instituted a quarterly dividend of $0.15 per share in recognition of the company's significant cash assets and the continued stability and growth of BPO Properties' earnings.
- Declared a special dividend of $15 per share to shareholders of record March 1, 2004.

Future Growth

BPO Properties remains well positioned for growth and relatively insulated from soft rental rate conditions owing to our long-term leases with high-quality tenants, coupled with our aggressive lease renewal program. The oil and gas sectors in Calgary remain strong, resulting in increased leasing activity and absorption levels. In Toronto and Vancouver, overall economic signs are promising but we expect demand to improve only moderately. We are encouraged that pressure on rental rates from sublease space has decreased in both Toronto and Calgary.

We remain focussed on three strategic priorities:

- *Progressive tenant services and state-of-the-art technical infrastructure* to maintain the quality of our portfolio and a stable and satisfied tenant base
- *Surfacing value* from our properties through pro-active leasing and select redevelopment initiatives
- *Prudent capital management* including the refinancing and sale of interests in our mature properties

In addition, as the economy rebounds, continued supply constraints could create opportunities for us. With interests in two high-quality, centrally-located development properties in downtown Toronto comprising approximately three million square feet, we will seek to monetize these assets through development when our risk-adjusted return hurdles and significant pre-leasing targets with one or more lead tenants have been met.

Outlook

We are committed to implementing our focussed strategy to continue moving the company forward. Our long-term lease profile, in conjunction with a strong balance sheet and significant financial flexibility, provide the solid foundation for achieving our performance targets for 2004.

We would like to thank all of our investors, tenants, business partners and employees for their continued support as we have transformed BPO Properties from a small portfolio of commercial properties into one of Canada's leading office property companies. In particular, we would like to acknowledge David Arthur for his dedication and service to BPO Properties through the years and wish him well in all future endeavours.

On behalf of the management and Board of Directors,

Tom Farley

Thomas F. Farley
President and Chief Executive Officer

February 18, 2004

Exchange Tower, Toronto; Atrium on Bay, Toronto; Bankers Hall, Calgary

FINANCIAL HIGHLIGHTS

All amounts expressed in Canadian dollars

(Millions, except per share information)	**2003**	2002	2001
Portfolio of commercial properties			
Book value	**$ 1,040**	$ 1,122	$ 1,448
Net rentable area (Sq. Ft.)	**14**	15	14
Results of operations			
Funds from operations			
Prior to property disposition gains	**$ 128**	$ 124	$ 123
Including property disposition gains	**132**	220	173
Net income			
Prior to property disposition gains	**91**	89	70
Including property disposition gains	**94**	167	107
Financial position			
Total assets	**$ 2,022**	$ 1,976	$ 2,001
Shareholders' equity			
Preferred equity	**382**	382	382
Common equity	**872**	800	644
Per common share			
Funds from operations			
Prior to property disposition gains	**$ 4.07**	$ 3.98	$ 3.68
Including property disposition gains	**4.20**	7.34	5.42
Net income			
Prior to property disposition gains	**2.74**	2.73	1.83
Including property disposition gains	**2.84**	5.47	3.12

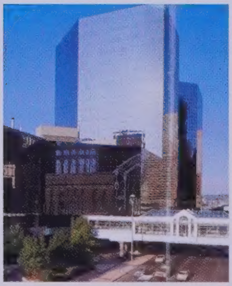
PROPERTIES PORTFOLIO

Property Name	Leased	Major Tenants	Net Leasable Area (000s Sq. Ft.)	Percentage Owned
Toronto, Ontario				
Exchange Tower and TSE Pavilion	98.9%	Toronto Stock Exchange, Weir Foulds LLP, Department of Justice, Altamira Investment Services/National Bank of Canada	1,029	50%
Atrium on Bay	93.6%	CIBC, Bell Canada, Alcohol and Gaming Commission	1,051	50%
Queen's Quay Terminal	92.2%	Labatt Brewing Company, CIT Financial, Noranda	504	100%
HSBC Building	99.7%	HSBC, SEI Investments Canada	194	100%
105 Adelaide Street West	83.2%	Lombard Insurance	184	100%
20-22 Front Street West	99.2%	CIBC	144	100%
Bay-Adelaide Centre (1)			1,266	50%
Hudson's Bay Centre (2)			797	25%
Calgary, Alberta				
Bankers Hall	97.5%	Canadian Natural Resources, EnCana Corporation, Talisman Energy, CIBC, Bennett Jones, RBC Financial Group	2,176	50%
Petro-Canada Centre	98.7%	Petro-Canada, Precision Drilling, Bell West	1,732	50%
Fifth Avenue Place	99.0%	Imperial Oil, Anadarko Canada, Enbridge, Westcoast Energy	1,475	50%
Gulf Canada Square	94.5%	Conoco Canada, CP Rail, Baker Hughes Canada	1,124	20%
Vancouver, British Columbia				
Royal Centre	85.7%	RBC Financial, Lang Michener, TimberWest Forest, Bull Housser & Tupper	595	100%
Parking and other			2,143	54%
Total portfolio	96.2%		14,414	53%
Less proportionate share owned by others			(6,844)	47%
BPO's net effective ownership interest			7,570	53%

(1) *Development opportunity*

(2) *Property under re-development*

FOCUS ON VALUE: GULF CANADA SQUARE



Gulf Canada Square, Calgary

Our strategy to surface value from an asset is three tiered: acquiring premier properties that are under-performing, then pro-actively managing the operations to maximize occupancy and cash flow, and finally, selling full or partial interests to investors seeking stable returns.

Acquisition

Acquired a 20% interest in 2002 based on a property valuation of $175 million.

Asset Management

Early renewal of a 400,000 square foot lease completed in 2003.

Disposition

Sold a 20% interest based on a property valuation of $222 million in February 2004.

Management's Discussion and Analysis of Financial Position and Operations

INTRODUCTION

BPO Properties Ltd. ("BPO") is a publicly-listed Canadian real estate investment company focussed on ownership and value enhancement of premier commercial office properties in select markets in Canada. The company is listed under the symbol BPP on the Toronto Stock Exchange.

The following discussion and analysis is intended to provide readers with an assessment of the company's performance over the past two years as well as its financial position and future prospects, and is meant to be read in conjunction with the audited consolidated financial statements and appended notes which begin on page 16 of this report. Much of the discussion of operating performance is based on funds from operations for the reasons discussed on page 10. The company also provides a full reconciliation to net income and an assessment of its performance on the same basis. Additional information, including the company's Annual Information Form, is available on the company's Web site at www.bpoproperties.com or on SEDAR's Web site at www.sedar.com.

ASSET OVERVIEW

At December 31, 2003, BPO's total assets increased by $46 million to $2.02 billion primarily due to cash generated from operations and new financing on Petro-Canada Centre in Calgary. A breakdown of the total assets is as follows:

(Millions)	**2003**	**% of Total**	2002	% of Total
Operating properties				
Office	**$ 924**	**89%**	$ 934	83%
Development	**116**	**11%**	178	16%
Retail	**—**	**—**	10	1%
	1,040	**100%**	1,122	100%
Other assets				
Cash and cash equivalents	**491**		667	
Marketable securities	**350**		—	
Loans receivable	**50**		74	
Future income taxes	**59**		74	
Other assets	**32**		39	
	$ 2,022		$ 1,976	

COMMERCIAL PROPERTIES

The commercial property portfolio is comprised of interests in 17 properties with a book value of $1 billion at December 31, 2003. This compares with 19 properties and a book value of $1.1 billion at December 31, 2002. The decrease in book value of commercial properties relates to the disposition of a residential condominium development and a retail property, discussed in further detail on page 7. A listing of the significant properties in the portfolio is provided on the opposite page. The following table summarizes the real estate portfolio at December 31:

	Number of Properties	Leasable Area (000s Sq. Ft.)	BPO Owned Interest (000s Sq. Ft.)	**2003 Book Value (Millions)**	2002 Book Value (Millions)
Office	15	11,644	6,458	**$ 924**	$ 934
Development	2	2,770	1,112	**116**	178
Retail	—	—	—	—	10
Total	17	14,414	7,570	**$ 1,040**	$ 1,122

OFFICE PROPERTY PORTFOLIO

The company's premier office portfolio is located primarily in the downtown cores of Toronto, Calgary and Vancouver. The consolidated carrying value of the company's interest in 6.5 million square feet of rentable area is approximately $143 per square foot, significantly less than the estimated replacement cost of these assets. The average size of the company's major office properties is one million square feet of leasable area. Occupied and committed space in the office portfolio at December 31, 2003 remained virtually unchanged at 96.2% from 2002, well above the Canadian national average.

An important characteristic of BPO's portfolio is the strong credit quality of its tenants. Special attention is directed at credit quality in order to ensure the long-term sustainability of rental revenues through economic cycles. The following list shows the largest tenants by leasable area in BPO's portfolio and their respective lease commitments:

Tenant	Building(s)	Year of Expiry[1]	000s Sq. Ft.[2]	% of Sq. Ft.[2]	Credit Rating[3]
Rated					
Petro-Canada	Petro-Canada Centre	2013	851	7.3%	BBB
CIBC	Bankers Hall, 22 Front, Atrium on Bay	2019	603	5.2%	A+
Imperial Oil	Fifth Avenue Place	2011	565	4.9%	AAA
Canadian Pacific Railway Co.	Gulf Canada Square	2013	447	3.8%	A-
Talisman Energy	Bankers Hall	2015	446	3.8%	BBB+
Conoco Canada Resources	Gulf Canada Square	2010	444	3.8%	A-
Royal Bank	Royal Centre, Bankers Hall, Hudson's Bay Centre	2023	428	3.7%	AA-
Bell Canada/Bell West Inc.	Petro-Canada Centre, Atrium on Bay	2010	278	2.4%	A-
Anadarko Canada Corporation	Fifth Avenue Place	2011	269	2.3%	Baa1
Canadian Natural Resources	Bankers Hall	2011	257	2.2%	BBB+
EnCana Corporation	Bankers Hall	2013	229	2.0%	A-
Precision Drilling Corp.	Petro-Canada Centre	2010	183	1.6%	BBB+
Enbridge Inc.	Fifth Avenue Place	2013	164	1.4%	A-
Westcoast Energy	Fifth Avenue Place, Royal Centre	2012	154	1.3%	BBB+
Amdocs Canada Inc	Hudson's Bay Centre	2012	149	1.3%	Baa3
CIT Group	Queen's Quay Terminal	2009	147	1.3%	A-
Lombard Insurance	105 Adelaide Street	2011	132	1.1%	BBB
HSBC Of Canada	HSBC Building	2011	100	0.9%	A+
				50.3%	
Unrated					
Toronto Stock Exchange	Exchange Tower	2018	179	1.5%	—
The Bay	Hudson's Bay Centre	2009	161	1.4%	—
Bennett Jones	Bankers Hall	2010	154	1.3%	—
Department of Justice	Exchange Tower	2005	144	1.2%	—
Fraser Milner	Fifth Avenue Place	2008	84	0.7%	—
Calpine Canada Natural Gas	Petro-Canada Centre, Bankers Hall	2008	80	0.7%	—
				57.1%	

(1) *Weighted average based on square feet*

(2) *Prior to considering partnership interests in partially-owned properties*

(3) *From Standard and Poor's, Moody's or Dominion Bond Rating Service (DBRS)*

BPO's strategy is to sign long-term leases in order to mitigate risk and reduce overall re-tenanting costs in the portfolio. The company typically commences discussions with tenants regarding their space requirements well in advance of the contractual expiration. BPO's portfolio has a weighted average lease life of eight years. Following is a breakdown of lease maturities by market with associated in-place rental rates:

	Total Portfolio			Toronto			Calgary			Vancouver		
Year of Expiry	000s Sq. Ft.	%	Net Rate per Sq. Ft.-$	000s Sq. Ft.	%	Net Rate per Sq. Ft.-$	000s Sq. Ft	%	Net Rate per Sq. Ft.-$	000s Sq. Ft.	%	Net Rate per Sq. Ft.-$
Currently available	391	3.8%		151	4.8%		155	2.4%		85	14.3%	
2004	472	4.6%	$ 15	362	11.6%	$ 13	83	1.3%	$ 23	27	4.5%	$ 15
2005	764	7.5%	18	478	15.4%	18	248	3.8%	17	38	6.4%	14
2006	454	4.4%	17	187	6.0%	15	221	3.4%	19	46	7.7%	16
2007	609	6.0%	18	383	12.3%	17	139	2.1%	22	87	14.6%	19
2008	581	5.7%	23	258	8.3%	24	317	4.9%	20	6	1.0%	20
2009	319	3.1%	23	190	6.1%	24	98	1.5%	21	31	5.2%	20
2010	931	9.1%	25	80	2.6%	28	824	12.7%	25	27	4.5%	17
2011 & beyond	7,123	55.8%	22	1,230	32.9%	27	5,387	67.9%	22	506	41.8%	20
	11,644	100.0%	$ 18	3,319	100.0%	$ 17	7,472	100.0%	$ 18	853	100.0%	$ 14
Weighted average market net rent			$ 24			$ 27			$ 23			$ 20

Office rental rates remained stable during 2003, reflecting economic conditions in Toronto and the effect of the strong oil and natural gas industry in Calgary. As leases expire, the company expects to capitalize on the positive market conditions that exist to increase occupancy and in-place rental rates throughout the portfolio. In-place rental rates stood at an average of $18 per square foot, representing a discount of over 30% from the market rate for similar space.

DEVELOPMENT PROPERTY PORTFOLIO

At December 31, 2003, development properties consisted of the following commercial property development sites:

	Location	Buildable Sq. Ft.	Ownership %	Dec. 31, 2003 (Millions)
Bay-Adelaide Centre	Bay and Adelaide Streets, Toronto	1,678,000	50%	$ 83
Hudson's Bay Centre	Yonge and Bloor Streets, Toronto	1,092,000	25%	33
		2,770,000		$ 116

BPO is not a speculative developer; the company is a full-service real estate company with in-house development expertise. With approximately 3 million square feet of high-quality, centrally-located development properties in Toronto, the company would undertake development of these sites only when the risk-adjusted return criteria and significant pre-leasing levels for at least 50% to 60% of the space have been achieved.

RETAIL PROPERTY PORTFOLIO

In September 2003, the company completed its strategy of exiting the retail market by selling its interest in Merivale Place for net proceeds of approximately $25 million, generating a gain of approximately $4 million. The 2002 dispositions included a retail property in Edmonton, and certain community centres in Toronto. These dispositions generated net proceeds of $147 million in 2002.

TENANT INSTALLATION COSTS AND CAPITAL EXPENDITURES

Upon the signing of the majority of its leases, BPO provides tenant improvements for leased space in order to accommodate the specific space requirements of the tenant. In addition to this capital, leasing commissions are paid to third-party brokers representing tenants in lease negotiations. Tenant improvement costs are capitalized in the year incurred, amortized over the term of the lease and recovered through rental payments. Expenditures for tenant improvements in 2003 totaled $9 million, compared with the $17 million expended in 2002, primarily due to the leasing of Bankers Hall. Tenant installation costs are summarized as follows:

(Millions)	**2003**	2002
Commercial property tenant improvements		
Tenant improvements	$ 7	$ 15
Leasing commissions	2	2
Total	$ 9	$ 17

BPO also invests in on-going maintenance and capital improvement projects to sustain the high quality of the infrastructure and tenant service amenities in its properties. Due to the relatively recent construction and major renovation of BPO's core properties, as well as high-quality construction standards, recurring capital maintenance expenditures are lower than industry norms. Capital maintenance expenditures totaled $10 million in 2003, consistent with 2002. These expenditures exclude repairs and maintenance costs which are recovered through contractual tenant cost recovery payments.

Revenue enhancing capital expenditures represent improvements to an asset, reconfiguration of space to increase rentable area or increase current rental rates, and non-revenue enhancing expenditures, those required to maintain the service life of an asset, are summarized as follows:

(Millions)	**2003**	2002
Capital expenditures		
Revenue enhancing	$ 6	$ 6
Non-revenue enhancing	4	4
Total	**$ 10**	$ 10

OFFICE ACQUISITIONS AND DISPOSITIONS

The disposition of full or partial interests in properties reflects BPO's strategy to acquire undervalued assets in its core markets, enhance the value through re-leasing and financing initiatives, and sell full or partial interests in stable, long-term leased properties to institutional investors looking for consistent yields. In 2003, the company did not complete any acquisitions or dispositions of commercial properties but has sufficient capital to acquire properties when a potential acquisition meets the company's investment criteria.

In August 2002, the company sold a 50% interest in Bankers Hall in Calgary based on a gross value of $608 million. This transaction generated net proceeds of $113 million and a gain of $31 million. In March 2002, the company sold an undivided 50% interest in Exchange Tower in Toronto based on a gross value of $320 million, generating proceeds of $90 million, net of non-recourse property debt, and a gain of $65 million.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents decreased to $491 million during 2003 as cash generated from operations and proceeds from property dispositions and a refinancing were offset by investments in marketable securities.

MARKETABLE SECURITIES

During 2003, the company purchased a $350 million portfolio of high-grade investment bonds, taking advantage of its financial resources to achieve improved returns without incurring significant levels of risk or sacrificing liquidity. This balance represents a significant advantage to the company as it has sufficient capital to react quickly to potential investment opportunities.

LOANS RECEIVABLE

The company had $50 million in loans receivable at December 31, 2003, compared with $74 million at December 31, 2002. This decrease is due primarily to early repayment on loans having a contractual maturity of 2008. Contractual maturity of the gross loans receivable in the loan portfolio is 2007.

LIQUIDITY AND CAPITAL RESOURCES

BPO employs a broad range of financing strategies to facilitate growth and manage financial risk, with particular focus on the overall reduction of the weighted average cost of capital, thereby enhancing returns for common shareholders. BPO's funds from operations, defined as income from commercial properties prior to non-cash taxes and depreciation, represents the primary source of liquidity to fund debt services, dividend payments and recurring capital and leasing costs in the company's commercial property portfolio. Sufficient cash flows are generated by the company's properties to service these obligations. In addition, BPO's tax status as a corporation and substantial tax loss pools allow it to reinvest and retain cash generated by operations without incurring cash taxes. The company's capital structure is summarized as follows:

(Millions)	2003	%	2002	%
Commercial property debt	$ 703	36%	$ 696	37%
Shareholders' equity				
Preferred shares	382	20%	382	20%
Common shares	872	44%	800	43%
	1,254	64%	1,182	63%
	$ 1,957	100%	$ 1,878	100%

COMMERCIAL PROPERTY DEBT

Commercial property debt represents property-specific debt where recourse is limited to the underlying asset. At December 31, 2003, the company's debt profile had a weighted average interest rate of 7%, an interest coverage ratio of 3.9 times and an average maturity of eight years. Commercial property debt maturities for the next five years and thereafter are as follows:

(Millions) Year	Scheduled Amortization	Maturities	Total	Weighted Average Interest Rate
2004	$ 13	$ 23	$ 36	7.1%
2005	13	39	52	7.0%
2006	13	—	13	7.0%
2007	14	42	56	7.1%
2008	14	125	139	7.3%
2009 and thereafter	47	360	407	7.3%
	$ 114	$ 589	$ 703	7.0%

The largest property debt, in order of maturity, are as follows:

Property	Location	Interest Rate %	Maturity Date	BPO's Share (Millions)	Mortgage Details
Atrium on Bay	Toronto	7.71%	2005	$ 41	Non-recourse – fixed rate
105 Adelaide	Toronto	5.77%	2007	25	Non-recourse – fixed rate
Petro-Canada Centre	Calgary	6.43%	2008	137	Non-recourse – fixed rate
Queen's Quay Terminal	Toronto	7.26%	2011	38	Non-recourse – fixed rate
Fifth Avenue Place	Calgary	7.59%	2011	80	Non-recourse – fixed rate
HSBC Building	Toronto	8.19%	2012	26	Non-recourse – fixed rate
Exchange Tower	Toronto	6.83%	2012	68	Non-recourse – fixed rate
Bankers Hall	Calgary	7.20%	2013	185	Non-recourse – fixed rate
Royal Centre	Vancouver	7.50%	2022	54	Non-recourse – fixed rate
Other				49	Various terms
		7.04%		$ 703	

SHAREHOLDERS' EQUITY

The company has the following preferred shares issued and outstanding:

(Millions except share information)	Shares Outstanding	Cumulative Dividend Rate	2003	2002
Series G	1,805,489	70% of bank prime	**$ 45**	$ 45
Series J	3,816,527	70% of bank prime	**96**	96
Series K	300	30-day BA + 0.4%	**150**	150
Series M	2,847,711	70% of bank prime	**71**	71
Series N	800,000	30-day BA + 0.4%	**20**	20
Total			**$ 382**	$ 382

At December 31, 2003, the company had 28.5 million common shares issued and outstanding. The weighted average shares outstanding was 28.5 million (2002 – 28.5 million). There were no dilutive instruments outstanding.

DIVIDENDS

In 2003, the company paid $13 million of preferred share dividends (2002 – $11 million) and $9 million of common share dividends (2002 – nil). Subsequent to year-end, the Board of Directors declared a special common share dividend of $15 per share, totaling approximately $428 million, payable on March 31, 2004.

CREDIT RATINGS

BPO is currently rated by two agencies. The company is committed to arranging its affairs to maintain these ratings as well as to improve them further over time. The credit ratings for the company at December 31, 2003 and at the date of this report were as follows:

	DBRS	S&P
Corporate rating	BBB	BBB-
Preferred shares	Pfd-3	P-3

UTILIZATION OF CASH RESOURCES

The following table illustrates the utilization of free cash flow generated by the company's operations and financing initiatives as well as the reallocation of capital:

(Millions)	2003	2002	Total
Cash flow from operations	$ 163	$ 61	$ 224
Financing			
Borrowings, net of repayments	25	26	51
Shareholder distributions	(22)	(11)	(33)
	3	15	18
Investing			
Marketable securities	(350)	—	(350)
Dispositions of real estate, net	25	242	267
Development and redevelopment	(7)	(34)	(41)
Capital expenditures	(10)	(10)	(20)
	(342)	198	(144)
(Decrease) increase in cash	$(176)	$ 274	$ 98

FUNDS FROM OPERATIONS

Funds from operations is defined as net income prior to non-cash items, depreciation and amortization of capital assets. While BPO believes that funds from operations is the most relevant measure to analyze real estate based on the fact that commercial properties generally appreciate rather than depreciate, the company believes that both funds from operations and net income are relevant measures. The company computes funds from operations in accordance with the definitions provided by the Canadian Institute of Public and Private Real Estate Companies ("CIPPREC"). Funds from operations does not represent cash generated from operating activities determined in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and should not be considered as an alternative to net income determined in accordance with GAAP.

BPO's strong tenant base and pro-active leasing strategies contributed to an increase in funds from operations prior to property disposition gains of $128 million or $4.07 per share in 2003, compared with $124 million or $3.98 per share in 2002. Including gains, funds from operations decreased to $132 million or $4.20 per share in 2003 compared to $220 million or $7.34 per share in 2002. The 2003 results included $4 million of gains realized on the disposition of Merivale Place, and the 2002 results included $96 million of gains realized on the sale of 50% interests in Exchange Tower in Toronto and Bankers Hall in Calgary.

After providing for preferred share dividends, BPO's funds from operations per share prior to and including gains, are as follows:

	2003		2002	
(Millions, except per share amounts)	Total	Excluding Gains	Total	Excluding Gains
Funds from operations	$ 132	$ 128	$ 220	$ 124
Preferred dividends	(13)	(13)	(11)	(11)
Funds available for common shareholders	$ 119	$ 115	$ 209	$ 113
Weighted average shares outstanding	28.5	28.5	28.5	28.5
Funds from operations per share	$ 4.20	$ 4.07	$ 7.34	$ 3.98

RESULTS OF OPERATIONS

Net operating income contributed by the same commercial properties totaled $108 million in 2003, an increase of 20% over $90 million in 2002. Total net operating income during 2003 included $2 million contributed by properties disposed of during 2003. These dispositions, as well as dispositions in 2002, contributed net operating income of $24 million in 2002.

(Millions)	2003	2002
Operating income from current properties	$ 108	$ 90
Operating income from properties sold	2	24
Net operating income prior to property disposition	$ 110	$ 114

NET OPERATING INCOME

(Millions)	2003	2002
Commercial properties		
Revenue	$ 216	$ 227
Expenses	106	113
Net rental income	110	114
Loans and investment income	71	66
	$ 181	$ 180

Revenue from commercial properties includes rental revenues earned from tenant leases, percentage rent and additional rent from the recovery of operating costs and property taxes. Revenue from commercial properties totaled $216 million in 2003, a decrease of $11 million compared with 2002. The decrease in revenue from 2002 was a result of sale of 50% interests in core office properties and dispositions of non-core retail assets, offset by increases in rental rates on lease rollovers and additional revenues related to acquisitions made in 2002.

Commercial property operating expenses are comprised of the costs of direct property operations including property taxes, salaries, utilities, insurance, and other costs of ownership such as professional fees and capital taxes. Property expenses decreased by $7 million to $106 million, the result of property dispositions during 2002 and 2003. Net rental income decreased by $4 million to $110 million in 2003, primarily due to dispositions during 2002.

COMPONENTS OF NET OPERATING INCOME

Net operating income growth is comprised of contractual increases on in-place leases, rental increases achieved on in-place rents when re-leased, lease-up of vacancies, and acquisitions, net of dispositions. The growth in net operating income over the past two years is as follows:

(Millions)	2003	2002
Net operating income prior to property disposition gains, prior year	$ 114	$ 153
(a) Contractual increases on in-place leases	5	2
(b) Rental increases achieved on in-place rents when re-leased	3	1
(c) Lease-up of vacancies	1	1
(d) Acquisitions, net of dispositions	(13)	(43)
Net operating income, end of year	$ 110	$ 114

(a) Contractual increases on in-place leases

During 2003, net operating income increased $5 million from contractual increases, compared with $2 million in 2002. BPO's leases generally have clauses which provide for the collection of rental revenues in amounts that increase every five years, with these increases negotiated at the signing of the lease. The high-credit quality of tenants in the company's portfolio lowers the risk in realizing these increases. It is the company's policy to record revenues in accordance with the actual payments received under the terms of its leases, which typically increase over time due to the contractual increases in rental payments over the term of the lease. However, accounting standards and industry practices are expected to mandate straight-line rent recognition for 2004 which would have the impact of realizing those contractual steps on a straight-line basis over the term of the lease. For further discussion of future accounting policy changes, refer to Note 1 on page 20.

(b) Rental increases achieved on in-place rents when re-leased

During 2003, higher rental rates on the re-leasing of space in the portfolio contributed $3 million of increased net operating income over 2002. At December 31, 2003, average in-place net rents throughout the portfolio increased to $18 per square foot compared with $17 per square foot at December 31, 2002. Despite challenging leasing environments in BPO's major markets, the company was able to marginally increase its in-place net rental rate, largely a result of re-leasing initiatives which were completed on space leased in 2001 and significant re-leasing initiatives in 2002 and 2003 at equivalent rental rates. The 2003 average market rents remained consistent with the year 2002 as the combined pressure of sublease space and decreased tenant demand continued. The following table shows the average in-place rents and estimated current market rents for similar space in each of the company's markets:

	Gross Leasable Area (000s Sq. Ft.)	Average Lease Term (Years)	Avg. In-place Net Rent Dec. 31, 2003 ($ per Sq. Ft.)	Avg. Market Net Rent Dec. 31, 2003 ($ per Sq. Ft.)
Toronto, Ontario	3,319	6	$ 17	$ 27
Calgary, Alberta	7,472	9	18	23
Vancouver, British Columbia	853	12	14	20
Total*	11,644	8	$ 18	$ 24

** Excludes developments*

(c) Lease-up of vacancies

A total of approximately 2.6 million square feet of vacant space was leased in 2003 and 2002, contributing $1 million to net operating income during 2003. Contributions from vacancy lease-ups was greater in previous years due to vacancies leased in properties acquired in 2000. BPO's total portfolio occupancy rate at December 31, 2003 declined from 96.3% to 96.2% primarily due to vacancy increases in Vancouver, which was caused by the partial return of space by one of the company's tenants at the end of their long-term lease. However, this space was subsequently leased to a new tenant in 2004 which will increase Vancouver's occupancy to approximately 95%.

A summary of current and historical occupancy levels for the past two years is as follows:

	Dec. 31, 2003		Dec. 31, 2002	
(Thousands of square feet)	**Total Square Feet**	**% Leased**	Total Square Feet	% Leased
Toronto, Ontario	**3,319**	**95.2%**	3,466	94.4%
Calgary, Alberta	**7,472**	**97.6%**	7,472	97.4%
Vancouver, British Columbia	**853**	**85.7%**	853	94.5%
Total*	**11,644**	**96.2%**	11,791	96.3%

** Excludes developments*

(d) Acquisitions, net of dispositions

The value created in BPO's mature commercial properties provides the company with the opportunity to generate additional gains and capital in order to reinvest in other assets at higher returns. The sale of properties reduced net operating income by $13 million in 2003 and $43 million in 2002. In 2002, BPO sold partial interests in two of its core properties, Exchange Tower in Toronto and Bankers Hall in Calgary.

LOANS AND INVESTMENT INCOME

During 2003, loans and investment income contributed $71 million to net income for the year ended December 31, 2003, up from $66 million in 2002. The increase is attributable to interest earned on cash deposits, the collection of a previously written-off vendor take back mortgage from a disposed retail property, offset by a decrease in investment income earned through the company's joint venture with a residential condominium developer on the retail/condominium development No. 10 Bellair.

EXPENSES

A breakdown of the company's expenses is as follows:

(Millions)	2003	2002
Interest expense	$ 44	$ 48
Administrative	6	5
Large corporation tax	3	3
	$ 53	$ 56

Interest expense declined to $44 million in 2003 from $48 million in 2002 due to a decrease in commercial property debt as a result of the sale of partial interests, offset by acquisitions of partial interests of the company's core properties during 2002. During 2003, interest capitalized on development projects totaled $4 million (2002 – $5 million). Administrative expenses consist primarily of $5 million in fees (2002 – $5 million) paid to a related company for operating the company as discussed in further detail in Note 10 on page 26 and professional fees and costs related to BPO's public company status. Administrative costs increased to $6 million in 2003 from $5 million in 2002 due to the costs incurred in pursuing development and acquisition opportunities. Large corporation tax paid totaled $3 million during 2003, consistent with 2002.

NET INCOME

Net income prior to property disposition gains was $2.74 per share in 2003, an increase over $2.73 per share in 2002. Net income including gains was $94 million or $2.84 per common share, compared with $167 million or $5.47 per common share in 2002. The increase in per share amounts before gains is a result of improved current year operating performance in the commercial property portfolio. BPO's net income per share including and excluding gains is calculated as follows:

	2003		2002	
(Millions, except per share amounts)	Total	Excluding Gains	Total	Excluding Gains
Net income	$ 94	$ 91	$ 167	$ 89
Preferred dividends	(13)	(13)	(11)	(11)
Net income available for common shareholders	$ 81	$ 78	$ 156	$ 78
Weighted average shares outstanding	28.5	28.5	28.5	28.5
Net income per share	$ 2.84	$ 2.74	$ 5.47	$ 2.73

It should be noted that challenges of comparability of net income exist among various real estate companies, as those entities structured as corporations such as BPO are required to charge their earnings with tax expense, despite the presence of tax losses which reduce the cash tax obligation. This differs from those entities which operate as real estate investment trusts ("REIT"), as REITs are not subject to taxation, provided they remain in compliance with specific tax codes. If the impact of taxes was eliminated, net income would increase by $0.52 per share in 2003 and $1.09 per share in 2002.

CORPORATE GUARANTEES AND CONTINGENT OBLIGATIONS

The company may be contingently liable with respect to litigation and claims that arise in the normal course of business. In addition, the company may execute agreements that provide for indemnifications and guarantees to third parties. Disclosure of commitments, guarantees and contingencies can be found in the notes to the financial statements.

SEGMENTED INFORMATION

BPO Properties invests in office and development properties within Canada. Details of the segmented financial information for the company's principal areas of business are provided in Note 9 on page 26 of the consolidated financial statements.

QUARTERLY RESULTS

The 2003 and 2002 results by quarter are as follows:

	Q1		Q2		Q3		Q4	
(Millions, except per share amounts)	2003	2002	2003	2002	2003	2002	2003	2002
Total revenue and gains	$ 73	$ 143	$ 73	$ 69	$ 81	$ 104	$ 64	$ 73
Net operating income								
Commercial property operations								
Operating income from current properties	$ 25	$ 20	$ 30	$ 22	$ 26	$ 24	$ 27	$ 24
Operating income from properties sold	1	12	1	8	—	3	—	1
Total commercial property operations	26	32	31	30	26	27	27	25
Loans and investment income	19	14	16	11	26	21	10	20
	45	46	47	41	52	48	37	45
Expenses								
Interest	11	14	11	13	11	11	11	10
Administrative and large corporation tax	2	2	2	2	3	2	2	2
Income before the following items	32	30	34	26	38	35	24	33
Gains on dispositions of properties	1	65	—	—	3	31	—	—
Income before undernoted	33	95	34	26	41	66	24	33
Depreciation and amortization	5	5	6	5	6	7	6	5
Future income taxes	7	19	7	3	10	13	(9)	(4)
Net income	$ 21	$ 71	$ 21	$ 18	$ 25	$ 46	$ 27	$ 32
Net income per common share								
Prior to property disposition gains	$ 0.60	$ 0.56	$ 0.60	$ 0.52	$ 0.69	$ 0.65	$ 0.85	$ 1.00
Property disposition gains	0.02	1.85	—	—	0.08	0.89	—	—
	$ 0.62	$ 2.41	$ 0.60	$ 0.52	$ 0.77	$ 1.54	$ 0.85	$ 1.00
Funds from operations per common share								
Prior to property disposition gains	$ 1.05	$ 0.99	$ 1.05	$ 0.80	$ 1.23	$ 1.11	$ 0.74	$ 1.08
Property disposition gains	0.03	2.28	—	—	0.10	1.08	—	—
	$ 1.08	$ 3.27	$ 1.05	$ 0.80	$ 1.33	$ 2.19	$ 0.74	$ 1.08

Operating income from current properties in the fourth quarter of 2003 remained relatively consistent with previous quarters at approximately $26 or $27 million. The second quarter of 2003 included recovery adjustments relating to prior year and various tenant termination payments.

Loans and investment income consists primarily of interest income on the company's cash deposits and loans receivable. The third quarter of 2003 included approximately $13 million on the collection of a vendor take-back mortgage on a previously disposed of retail property. The decrease compared with the prior year is a result of the decrease in investment income recognized from the company's joint venture condominium project.

Interest expense remained consistent throughout the year, but decreased compared with the first and second quarters of 2002 due to the disposition of partial interests in Exchange Tower in Toronto and Bankers Hall in Calgary. The increase in administrative expense in the third quarter of 2003 related to costs incurred with respect to costs incurred in pursuing development or acquisition opportunities.

The gain realized in the third quarter of 2003 related to the sale of the company's retail property Merivale, while the gains realized in the first and third quarters in 2002 related to the sale of 50% interests in Exchange Tower in Toronto and Bankers Hall, respectively.

REAL ESTATE INDUSTRY AND RISKS

BPO's strategy is to invest in high-quality commercial properties defined by the physical characteristics of the asset, but more importantly, the certainty of receiving rental payments from the tenants of those assets. BPO remains exposed to certain risks inherent in the commercial property business.

In evaluating BPO and its business, the following challenges and risk factors should be considered in addition to the other information contained in this annual report. Further discussion of the risk factors that should be considered can be found in BPO's Annual Information Form posted on the company's Web site at www.bpoproperties.com or on SEDAR's Web site at www.sedar.com.

Real estate investments are generally subject to varying degrees of risk depending on the nature of the property. These risks include changes in general economic conditions (such as the availability and cost of mortgage funds), local conditions (such as an oversupply

of space or a reduction in demand for real estate in the area), the attractiveness of the properties to tenants, competition from others with available space and the ability of the owner to provide adequate maintenance at an economical cost.

Certain significant expenditures, including property taxes, maintenance costs, mortgage payments, insurance costs and related charges must be made regardless of whether or not a property is producing sufficient income to service these expenses. BPO's properties are subject to mortgages, which require significant debt service payments. If BPO were unable or unwilling to meet mortgage payments on any property, losses could be sustained as a result of the mortgagee's exercise of its rights of foreclosure or of sale.

Real estate is relatively illiquid. Such illiquidity will tend to limit BPO's ability to vary its portfolio promptly in response to changing economic or investment conditions. Also, financial difficulties of other property owners resulting in distressed sales could depress real estate values in the markets in which the company operates in times of illiquidity.

BPO's commercial properties generate a relatively stable source of income from contractual tenant rent payments. Continued growth of rental income is dependent on strong leasing markets to ensure expiring leases are renewed and new tenants are found promptly to fill vacancies.

While the outlook for commercial office rents is positive in the longer term, 2004 may not provide the same level of increases in rental rates on renewal as compared to 2003. The company is, however, substantially protected against these short-term market conditions, since most of its leases are long-term in nature with an average term of eight years. A protracted disruption in the economy, such as the onset of a severe recession, could place downward pressure on overall occupancy levels and net effective rents.

BPO's commercial properties operations have insurance covering certain acts of terrorism for up to US$300 million of damage and business interruption costs. The company continues to seek additional coverage equal to the full replacement cost of its assets; however, until this type of coverage becomes commercially available on an economically reasonable basis, any damage or business interruption costs as a result of uninsured acts of terrorism could result in a material cost to the company.

OUTLOOK

The company believes that the positive fundamentals in the Canadian commercial real estate industry and particularly in the markets in which the company operates will continue into 2004. The company will continue to focus on maximizing the value of existing assets by increasing occupancy, realizing increases in rents on rollovers of leases, pro-actively taking back below-market leases, re-leasing at higher rates, pursuing redevelopment opportunities, and taking advantage of other income-generating activities within the portfolio. The company will also continue to pursue growth through acquisitions if the opportunities meet the company's investment criteria.

Craig J. Laurie
Senior Vice President and Chief Financial Officer

Management's Responsibility for Financial Reporting

The management of BPO Properties Ltd. is responsible for the preparation, content and integrity of the consolidated financial statements and all other financial information contained in this Annual Report. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles, using management's best estimates and judgements where appropriate. Financial information presented elsewhere in this Annual Report is consistent with that in the financial statements.

The management of the company has established and maintains a system of internal controls that provides reasonable assurance that assets are safeguarded, transactions are properly authorized and recorded, the company is in compliance with all applicable laws and that the financial records are reliable for preparing financial statements. The effectiveness of and compliance with this system of internal controls is monitored by management.

The Board of Directors oversees management's responsibility for financial reporting through its Audit Committee, currently comprised of three directors who are not officers or employees of the company. The Audit Committee meets regularly with management and the external auditors to review auditing and accounting matters, including the adequacy of the system of internal controls and the quality of the company's financial reporting. The auditors have full and unrestricted access to the Audit Committee.

The consolidated financial statements have been audited by Deloitte & Touche LLP, the independent auditors, in accordance with Canadian generally accepted auditing standards.

Tom Farley

Thomas F. Farley
President and Chief Executive Officer

Craig Laurie

Craig J. Laurie
Senior Vice President and Chief Financial Officer

Auditors' Report

To the Shareholders,

We have audited the consolidated balance sheets of BPO Properties Ltd. as at December 31, 2003 and 2002 and the consolidated statements of income, retained earnings and cash flow for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Deloitte + Touche LLP

Toronto, Canada
February 18, 2004

Chartered Accountants

Consolidated Balance Sheet

December 31 (Millions)	Note	2003	2002
Assets			
Commercial properties	2	**$ 1,040**	$ 1,122
Cash and cash equivalents	1, 10	**491**	667
Marketable securities	3	**350**	—
Loans receivable	4	**50**	74
Future income taxes	5	**59**	74
Other assets		**32**	39
		$ 2,022	$ 1,976
Liabilities and Shareholders' Equity			
Commercial property debt	6	**$ 703**	$ 696
Accounts payable and other liabilities		**65**	98
Shareholders' equity	7	**1,254**	1,182
		$ 2,022	$ 1,976

See accompanying notes to the consolidated financial statements

Approved by the Board,

Robert J. Harding
Director

Robert J. McGavin
Director

CONSOLIDATED STATEMENT OF INCOME

December 31 (Millions, except per share amounts)	Note	2003	2002
Commercial properties			
Revenue		$ 216	$ 227
Expenses		106	113
		110	114
Loans and investment income		71	66
		181	180
Expenses			
Interest expense		44	48
Administrative expenses and large corporation tax	5	9	8
Income before the following items		128	124
Gains on dispositions of properties		4	96
Income before undernoted		132	220
Depreciation and amortization		23	22
Future income taxes	5	15	31
Net income		$ 94	$ 167
Net income per common share	7	$ 2.84	$ 5.47

See accompanying notes to the consolidated financial statements

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

December 31 (Millions)	Note	2003	2002
Retained earnings, beginning of year		$ 721	$ 565
Net income		94	167
Common share dividends	7	(9)	—
Preferred share dividends	7	(13)	(11)
Retained earnings, end of year		$ 793	$ 721

See accompanying notes to the consolidated financial statements

Consolidated Statement of Cash Flow

December 31 (Millions)	2003	2002
Operating Activities		
Net income	$ 94	$ 167
Add (deduct)		
Depreciation and amortization	23	22
Future income taxes	15	31
Gains on dispositions of properties	(4)	(96)
Tenant improvements	(9)	(17)
Other working capital	44	(46)
	163	61
Investing Activities		
Acquisitions of properties	—	(51)
Development and redevelopment expenditures	(7)	(34)
Capital expenditures	(10)	(10)
Dispositions of properties	25	293
Marketable securities	(350)	—
	(342)	198
Financing Activities		
Debt arranged	37	37
Debt amortization and repayments	(12)	(11)
Common share dividends	(9)	—
Preferred share dividends	(13)	(11)
	3	15
(Decrease) increase in cash and cash equivalents	(176)	274
Cash and cash equivalents, beginning of year	667	393
Cash and cash equivalents, end of year	$ 491	$ 667

Notes to the Financial Statements

1. Significant Accounting Policies

(a) General

The consolidated financial statements of BPO Properties Ltd. (the "company") are prepared in accordance with generally accepted accounting principles as prescribed by the Canadian Institute of Chartered Accountants ("CICA"). The company's accounting policies and its financial disclosure are substantially in accordance with the recommendations of the Canadian Institute of Public and Private Real Estate Companies ("CIPPREC").

(b) Principles of consolidation

The consolidated financial statements include the accounts of all its subsidiaries and its proportionate share of assets, liabilities, revenues and expenses of joint ventures.

(c) Properties

(i) Commercial properties

Commercial properties held for investment are carried at the lower of cost less accumulated depreciation and net recoverable amount. For operating properties and properties held for long-term investment, a write-down to estimated net recoverable amount is recognized when a property's undiscounted future cash flow is less than its carried value. Projections of future cash flow take into account the specific business plan for each property and management's best estimate of the most probable set of economic conditions anticipated to prevail in the market.

Depreciation on buildings is provided on the sinking-fund basis over the useful lives of the properties to a maximum of 60 years. The sinking-fund method provides for a depreciation charge of an annual amount increasing on a compounded basis of 5% per annum. Depreciation is determined with reference to each rental property's carried value, remaining estimated useful life and residual value. Tenant improvements and re-leasing costs are deferred and amortized over the lives of the leases to which they relate.

(ii) Development properties – commercial

Commercial properties under development consist of properties for which a major repositioning program is being conducted and for properties which are under construction. These properties are recorded at the lower of cost, including pre-development expenditures, and the net recoverable amount.

(iii) Properties held for sale

Properties held for sale are recorded at the lower of cost and net realizable value.

(d) Capitalized costs

Costs are capitalized on commercial properties which are under development, including all expenditures incurred in connection with the acquisition, development, construction and initial predetermined leasing period. These expenditures consist of all direct costs, interest on debt that is related to these assets and certain administrative expenses. Ancillary income relating specifically to such properties during the development period is treated as a reduction of costs.

(e) Revenue recognition

Revenue from a commercial property is recognized upon the earlier of attaining a break-even point in cash flow after debt servicing, or the expiration of a reasonable period of time following substantial completion, subject to the time limitation determined when the project is approved. Prior to this, the property is categorized as a property under development, and related revenue is applied to reduce development costs.

The company has retained substantially all of the risks and benefits of ownership of its properties and therefore accounts for leases with its tenants as operating leases. Rental revenue includes percentage participating rents and recoveries of operating expenses, including property, capital and large corporation taxes. Percentage participating rents are recognized when tenants' specified sales targets have been met. Operating expense recoveries are recognized in the period that recoverable costs are chargeable to tenants.

(f) Reporting currency and foreign currency translation

The consolidated financial statements have been presented in Canadian dollars as the company's principal investments and cash flow are influenced primarily by the Canadian dollar. Assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the rate in effect at the balance sheet date. Revenues and expenses are translated at the weighted average rate in effect for the period presented.

(g) Income taxes

The company accounts for income taxes under the liability method. Under this method, future income tax assets and liabilities are calculated based on: (i) the temporary differences between the carrying values and the tax bases of assets and liabilities, and (ii) unused income tax losses, measured using substantively enacted income tax rates and laws that are expected to apply in the future as temporary differences reverse and income tax losses are used. See Note 5 for additional information on the composition of the income tax assets and expense.

(h) Per share calculations

Net income per common share has been calculated after providing for preferred share dividends using the weighted average number of common shares outstanding of 28.5 million (2002 – 28.5 million). The company had no dilutive instruments outstanding.

(i) Cash and cash equivalents

Cash and cash equivalents include $2 million (2002 – $1 million) which is designated for property-specific taxes and operating costs unless otherwise approved by the respective property mortgage holder.

(j) Marketable securities

Marketable securities are carried at the lower of cost and their estimated net realizable value with any valuation adjustments charged to income. This policy considers the company's intent to hold an investment through periods where quoted market values may not fully reflect the underlying value of that investment. Accordingly, there are periods where the "fair value" or the "quoted market value" may be less than cost. In these circumstances, the company reviews the relevant security to determine if it will recover its carrying value within a reasonable period of time and adjust it, if necessary. The company also considers the degree to which estimation is incorporated into valuations and any potential impairment relative to the magnitude of the related portfolio.

In determining fair values, quoted market prices are generally used where available and, where not available, management estimates the amounts which could be recovered over time or through a transaction with knowledgeable and willing third parties under no compulsion to act.

(k) Use of estimates

The preparation of financial statements, in conformity with Canadian generally accepted accounting principles, requires estimates and assumptions that affect the carried amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from estimates. Significant estimates are required in the determination of cash flows and probabilities in assessing net recoverable amounts and net realizable value, tax provisions, hedge effectiveness, and fair value for disclosure purposes.

(l) Derivative financial instruments

The company utilizes derivative financial instruments primarily to manage foreign exchange risks associated with marketable securities. Realized and unrealized gains and losses on derivative financial instruments designated as hedges of financial risks are included in income in the same period as when the underlying asset, liability or anticipated transaction affects income. The company documents its eligibility for hedge accounting, where appropriate, and assesses the effectiveness of these relationships based on the degree of expected future offsetting cash flows.

Financial instruments that are not designated as hedges are carried at estimated fair values, and gains and losses arising from changes in fair values are recognized in income in the period the changes occur. The use of non-hedging derivative contracts is governed by documented risk management policies and approved limits.

(m) Change in accounting policy

Effective January 1, 2003, the company adopted a new accounting guideline related to significant guarantees and indemnification agreements (Note 8).

(n) Future accounting policy changes

The following future accounting policy changes may have an impact on the company, although the impact, if any, has not been determined at this time. In December 2002, the Accounting Standards Board ("AcSB") issued handbook section 3063, "Impairment of Long-Lived Assets," effective prospectively for years beginning on or after April 1, 2003. This standard provides guidance on recognizing, measuring and disclosing the impairment of long-lived assets. The guidance requires that an impairment loss be recognized when the carrying value of an asset exceeds the total undiscounted cash flows expected from its use and eventual disposition. The impairment recognized is measured as the amount by which the carrying value exceeds its fair value. It is not expected that section 3063 would have a material impact on the company's financial statements.

In March 2003, the CICA issued section 3110, "Asset Retirement Obligations," effective for financial statements issued for fiscal years beginning on or after January 1, 2004. Section 3110 addresses the recognition and re-measurement of obligations associated with the retirement of a tangible long-lived asset. This standard provides that obligations associated with the retirement of tangible long-lived assets be recorded as liabilities when those obligations are incurred, with the amount of the liability initially measured at fair value. These obligations are capitalized to the book value of the related long-lived assets and are depreciated over the useful life of the related asset. It is not expected that section 3110 would have a material impact on the consolidated financial statements of the company.

In June 2003, the CICA issued Accounting Guideline ("AcG") 15, "Consolidation of Variable Interest Entities" (AcG 15), which is effective for fiscal year 2005 and provides guidance for applying the principles in section 1590, "Subsidiaries," to those entities defined as Variable Interest Entities (VIEs) and more commonly referred to as Special Purpose Entities (SPEs), in which the equity at risk is not sufficient to permit that entity to finance its activities without additional subordinated financial support from other parties, or equity investors lack voting control, an obligation to absorb expected losses, or the right to relieve expected residual returns. AcG 15 requires consolidation of VIEs by the Primary Beneficiary. The Primary Beneficiary is defined as the party who has exposure to the majority of a VIE's expected losses and/or expected residual returns. The impact of AcG 15 on the company's financial statements, if any, has not been determined at this time.

In July 2003, the CICA issued handbook section 1100, "Generally Accepted Accounting Principles." The section establishes standards for financial reporting in accordance with Canadian GAAP, and provides guidance on sources to consult when selecting accounting policies and determining appropriate disclosures when a matter is not dealt with explicitly in the primary sources of Canadian GAAP. The company has implemented the new section prospectively beginning on January 1, 2004. Due to the prospective nature of this change, there is no impact on the company's consolidated financial statements as of the implementation date; however, the standard will require the company to record income arising from tenant leases and depreciation on buildings on a straight-line basis.

In November 2003, the AcSB approved a revision to CICA section 3860, "Financial Instruments: Disclosure and Presentation," to require certain obligations that must or could be settled with a variable number of the issuer's own equity instruments to be presented as a liability. It is expected that section 3860 will not have any material impact on the company's financial statements.

Effective January 1, 2004, the company has adopted Accounting Guideline 13, "Hedging Relationships" (AcG 13), the new accounting guideline issued by the CICA addressing identification, designation, documentation and effectiveness of hedging relationships for the purposes of applying hedge accounting. Under AcG 13, hedge designation of derivative financial instruments is only allowed if, both at the inception of the hedge and throughout the hedge period, the changes in the fair value or cash flows of the derivative instruments are expected to substantially offset the fair value or cash flows of the underlying asset, liability or anticipated transaction. Realized and unrealized gains and losses on derivative financial instruments designated as hedges of financial risks will be included in income in the same period as when the underlying asset, liability or anticipated transaction affects income. It is expected that AcG 13 will not have a material impact on the company's financial statements.

2. Commercial Properties

(Millions)	2003	2002
Commercial properties	**$ 1,002**	$ 993
Development properties	**116**	178
Retail properties	**—**	11
Accumulated depreciation	**(78)**	(60)
	$ 1,040	$ 1,122

(a) During 2003, costs capitalized on development projects were comprised of direct construction costs of $13 million (2002 – $29 million) and interest costs of $4 million (2002 – $5 million). The estimated costs to complete projects under development total $1 million, of which $0.5 million was committed at December 31, 2003 (2002 – $12 million committed).

(b) Minimum amounts payable over the next five years, and in the aggregate thereafter in respect of ground leases related to commercial real estate properties, which have an aggregate net book value of $157 million, are as follows: 2004 – $4 million; 2005 – $4 million; 2006 – $4 million; 2007 – $4 million; 2008 – $4 million; and thereafter – $19 million. Amounts payable under ground leases ranging from 9 to 888 years are included in the above amounts for 10 years.

(c) The following amounts included in the consolidated financial statements represent the company's proportionate interests in commercial office property-related joint ventures:

(Millions)	2003	2002
Assets	$ 864	$ 926
Liabilities	549	565
Operating revenues	159	107
Operating expenses	78	54
Net income	36	22
Cash provided by operating activities	83	24
Cash provided by financing activities	29	7
Cash used in investing activities	(18)	(45)

The company, through its subsidiaries, is contingently liable for the obligations of the joint ventures. In each case, the assets of the joint venture are available for the purpose of satisfying such obligations.

3. Marketable Securities

Marketable securities are comprised of a $350 million portfolio of fixed-rate corporate bonds which are carried at cost with a fair value equal to their book value and an average yield of 2.4% which mature over the period 2005 to 2006.

4. Loans Receivable

(Millions)	2003	2002
Loans receivable	$ 51	$ 76
Accrued interest	5	5
Provisions	(6)	(7)
	$ 50	$ 74

The weighted average interest rate of loans receivable at December 31, 2003 is 11% (2002 – 11%).

5. Income Taxes

The future income tax asset as at December 31 is comprised of the following:

(Millions)	2003	2002
Future tax asset relating to operating and capital losses	$ 27	$ 40
Future tax asset relating to differences between tax and book basis	32	34
	$ 59	$ 74

At December 31, 2003, the company had non-capital income tax losses of approximately $196 million (2002 – $269 million) which are available to reduce taxable income of future years. These losses will expire over a seven year period up to the year 2010. The benefit of the tax losses, net of a valuation allowance, have been reflected in the future income tax asset.

The amount of non-capital losses and deductible temporary differences, for which no future income tax assets have been recognized, is $235 million. Future income tax expense consists of the following:

(Millions)	2003	2002
Future income tax expense at combined Canadian federal and provincial income tax rate of 35% (2002 – 37.5%)	$ 38	$ 74
Change in Canadian income tax rates	(2)	—
Recognition of tax assets previously not recognized	(19)	(22)
Non-taxable portion of capital gains and other income	(2)	(21)
Future income tax expense	$ 15	$ 31

Large corporation tax of $3 million was paid during the year (2002 – $3 million) and is included in administrative expenses and large corporation tax.

6. Commercial Property Debt

(Millions) Year	Scheduled Amortization	Maturities	Total	Weighted Average Interest Rate
2004	$ 13	$ 23	$ 36	7.1%
2005	13	39	52	7.0%
2006	13	—	13	7.0%
2007	14	42	56	7.1%
2008	14	125	139	7.3%
2009 and thereafter	47	360	407	7.3%
	$ 114	$ 589	$ 703	7.0%

Contractual mortgage principal repayments are as follows: 2004 – $36 million; 2005 – $52 million; 2006 – $13 million; 2007 – $56 million; 2008 – $139 million; and thereafter $407 million. During the year, debt totaling nil (2002 – $63 million) were assumed in conjunction with the acquisition of certain commercial properties, and debt totaling nil (2002 – $258 million) were assumed by the purchaser in conjunction with the disposition of certain commercial properties.

Cash interest paid totaled $46 million (2002 – $55 million). In 2002, the company maintained lines of credit which included a demand operating facility of up to $30 million which was fully drawn at December 31, 2002. In 2003, this facility was repaid in full. This facility bore interest at the bankers' acceptance rate plus 0.75% or at the prime rate. In addition, lines of credit included a revolving, unsecured credit facility of up to $75 million which was undrawn at December 31, 2002. In 2003, these lines of credit were extinguished. Interest on this facility was based on a bankers' acceptance rate plus 1%. Amounts drawn under the lines of credit were netted against cash and cash equivalents.

7. Shareholders' Equity

The consolidated statement of changes in shareholders' equity is as follows:

	2003				2002			
(Millions)	**Preferred Shares**	**Common Shares**	**Retained Earnings**	**Total**	Preferred Shares	Common Shares	Retained Earnings	Total
Balance, beginning of year	**$ 382**	**$ 79**	**$ 721**	**$ 1,182**	$ 382	$ 79	$ 565	$ 1,026
Net income	**—**	**—**	**94**	**94**	—	—	167	167
Common share dividends paid	**—**	**—**	**(9)**	**(9)**	—	—	—	—
Preferred share dividends paid	**—**	**—**	**(13)**	**(13)**	—	—	(11)	(11)
Balance, end of year	**$ 382**	**$ 79**	**$ 793**	**$ 1,254**	$ 382	$ 79	$ 721	$ 1,182

(a) Total common shares issued and outstanding at December 31, 2003 totaled 28.5 million (2002 – 28.5 million) shares, which included 21.7 million (2002 – 21.7 million) non-voting equity shares.

(b) Net income per common share has been calculated after the payment of preferred share dividends of $13 million (2002 – $11 million) using weighted average shares outstanding of 28.5 million (2002 – 28.5 million). There were no dilutive instruments outstanding.

Authorized share capital consists of 300,000 senior preferred shares, unlimited priority preferred shares, unlimited preferred shares issuable in series, unlimited common shares and unlimited non-voting equity shares. No senior preferred shares or priority preferred shares were issued and outstanding. Details of the preferred shares issued by the company are as follows:

		2003		2002	
		Number of Shares	**Amount (Millions)**	Number of Shares	Amount (Millions)
Cumulative redeemable preferred shares					
Series G	(a)	**1,805,489**	**$ 45**	1,805,489	$ 45
Series J	(b)	**3,816,527**	**96**	3,816,527	96
Series K	(c)	**300**	**150**	300	150
Series M	(b)	**2,847,711**	**71**	2,847,711	71
Series N	(d)	**800,000**	**20**	800,000	20
Total outstanding preferred shares			**$ 382**		$ 382

(a) Series G preferred shares are entitled to cumulative dividends at an annual rate equal to 70% of the average bank prime rate. The company may, at its option, redeem the shares at a price of $25 per share plus arrears on any accrued and unpaid dividends.

(b) Series J and M preferred shares are entitled to cumulative dividends at an annual rate equal to 70% of the average bank prime rate for the previous quarter. The company may, at its option, redeem the shares at a price of $25 per share plus arrears on any accrued and unpaid dividends.

(c) Series K preferred shares are entitled to cumulative dividends at the 30 day bankers' acceptance rate plus 0.4%. The company may, at its option, redeem the shares at a price of $500,000 per share plus an amount equal to all accrued and unpaid dividends.

(d) Series N preferred shares are entitled to cumulative dividends at the 30 day bankers' acceptance rate plus 0.4%. The company may, at its option, redeem the shares at $25 per share plus arrears on any accrued and unpaid dividends.

(e) Preferred share dividends totaling $13 million were paid in 2003 (2002 – $11 million).

8. Guarantees

In the normal course of operations, the company and its consolidated subsidiaries execute agreements that provide for indemnification and guarantees to third parties, in transactions such as dispositions and acquisitions of assets. In particular, the company provided income guarantees to the co-owners in connection with the sale of certain properties. These guarantees are based on a specified level of contractual occupancy until July 2007 and a specified rate of return until July 2005. Based on estimated levels of contractual occupancy and rate of return, the company has provided for potential payments of $3 million at the time of sale.

The company has also agreed to indemnify its directors and certain of its officers and employees. The nature of substantially all of the indemnification undertakings prevent the company from making a reasonable estimate of the maximum potential amount that could be required to pay third parties, as the agreements do not specify a maximum amount and the amounts are dependent upon the outcome of future contingent events, the nature and likelihood of which cannot be determined at this time. Historically, neither the company nor its consolidated subsidiaries have made significant payments nor do they expect to make any significant payments under such indemnification agreements.

9. Segmented Information

The company operated during 2003 and 2002 primarily as an investor in commercial office properties in Canada. The following summary presents segmented financial information for the company's principal areas of business:

	Office Properties		Development Properties		Loans and Other		Total	
(Millions)	2003	2002	2003	2002	2003	2002	2003	2002
Carrying value	$ 924	$ 934	$ 116	$ 188	$ 982	$ 854	$ 2,022	$ 1,976
Dispositions, net of acquisitions	—	203	25	39	—	—	25	242
Capital investments	19	26	7	35	—	—	26	61
Property revenue	$ 204	$ 202	$ 12	$ 25	$ —	$ —	$ 216	$ 227
Property expenses	98	101	8	12	—	—	106	113
	106	101	4	13	—	—	110	114
Loans and investment income	—	—	—	—	71	66	71	66
Operating income	106	101	4	13	71	66	181	180
Interest expense	(47)	(51)	4	4	(1)	(1)	(44)	(48)
Administrative expenses and large corporation tax	(6)	(6)	(1)	(1)	(2)	(1)	(9)	(8)
Gains on disposition of properties	—	96	4	—	—	—	4	96
Depreciation and amortization	(22)	(21)	(1)	(1)	—	—	(23)	(22)
Income before unallocated costs	31	119	10	15	68	64	109	198
Future income taxes							(15)	(31)
Net income							$ 94	$ 167

10. Related Party Transactions

The company has retained the services of a subsidiary of Brookfield Properties Corporation ("Brookfield"), the company's principal shareholder, for the property management of some of its office properties on contracts based on fair market value of services provided. The fees paid for these property management services totaled $5 million in 2003 (2002 – $6 million). The company previously entered into an agreement with Brookfield to provide asset management services for the company's property portfolio. The fees paid for these services, determined on a cost-recovery basis, totaled $5 million (2002 – $5 million). At December 31, 2003 the company had demand deposits of $481 million (2002 – $682 million) with Brookfield. Subsequent to year-end, $428 million of this deposit was used to fund the special common share dividend of $15 per share payable March 31, 2004. The 2002 deposits included $125 million with a subsidiary of Brookfield's principal shareholder. The deposits earn interest at market rates and were included in cash and cash equivalents. Interest earned on these deposits for the year ended December 31, 2003 amounted to $32 million (2002 – $24 million).

11. Risk Management and Financial Instruments

The company is exposed to financial risks that arise in the normal course of its business. These risks, and the actions taken to manage them, are as follows:

(a) Interest Rate Risk

The assets and liabilities of the company have both fixed and floating interest rate components resulting in an exposure to interest rate movements. The company has not hedged all of its exposure to interest rates, creating unmatched floating rate interest exposures which may affect the company's earnings in future periods. As at December 31, 2003, the company's floating rate assets exceeded its floating rate liabilities, including $382 million of floating rate preferred shares, by $448 million (2002 – $258 million).

(b) Credit Risk

The company's business includes direct investments in commercial real estate and real estate-based lending activities. Credit risk arises from the possibility that borrowers may default on their obligations to the company or, with respect to the underlying real estate properties that secure these obligations, that tenants may experience financial difficulty and be unable to fulfill their lease commitments. The company mitigates the risk of credit loss by limiting its exposure to any one group or borrower within prescribed limits and by ensuring that adequate security has been provided in support of loans.

(c) Market Risk

Investment returns are subject to a variety of risk factors both specific to individual investments and arising from general economic conditions.

(d) Currency Risk

The company is exposed to currency risk as it relates to its US dollar-denominated marketable securities. Changes in the applicable exchange rate may result in a decrease or increase in income or expense. The company has mitigated this risk by using foreign exchange forward swaps. At December 31, 2003, the company held US–Canadian dollar foreign exchange forward contracts with a notional amount of C$350 million.

(e) Fair Values

Fair values of assets and liabilities approximate amounts at which these items could be exchanged in a transaction between knowledgeable parties. The calculation of estimated fair value is based on market conditions at a specific point in time, in the respective geographic location based on the amount and timing of future cash flows and may not be reflective of future fair values. Changes in interest rates and investment risk are the primary causes of changes in the fair value of the company's financial instruments.

Cash and cash equivalents, short term investments and securities have an aggregate fair value that approximates their carrying values on December 31, 2003 and 2002 due to their short-term nature.

Fair values of loans receivable are determined by the company by discounting the expected future cash flows of these loans at market rates for loans with similar terms and investment risks. At December 31, 2003, the fair value of loans receivable exceed their carrying value by $2 million (2002 – $6 million). Changes in the interest rate environment and investment risk in one or more of the markets, in which the underlying loan security is located, may result in significant changes in fair values.

Fair values of commercial property debt are determined by reference to current market prices for debt with similar terms and risks. At December 31, 2003, the fair value of mortgages and other borrowings is above the carrying value of these obligations by $41 million (2002 – $32 million). The difference between fair value and carrying value relates to changes in the general level of interest rates that have occurred since the debt was placed or assumed.

12. Commitments and Contingencies

The company extended certain warranties in connection with the sale of former Canadian and international operating companies, including warranties against certain ordinary course legal proceedings outstanding at the dates of sale. The company is involved in various legal actions, the outcome of which is indeterminable. In management's opinion, the consolidated financial statements include adequate provisions for warranties and litigation based on information available at this time.

13. Subsequent Event

Subsequent to December 31, 2003, the company sold its 20% interest in Gulf Canada Square in Calgary based on a property valuation of $222 million. On February 18, 2004, the Board of Directors declared a special common share dividend of $15 per share, payable March 31, 2004 to shareholders of record at the close of business on March 1, 2004.

DIVIDEND RECORD AND PAYMENT DATES*

	Symbol	Stock Exchange	Record Date	Payment Date
Common Shares	BPP	Toronto	First day of March, June, September and December	Last day of March, June, September and December
Preferred Shares				
Series G	BPP.PR.G	Toronto	Last business day of January, April, July and October	Fourteenth day of February, May, August and November
Series J	BPP.PR.J	Toronto	Last business day of January, April, July and October	Fourteenth day of February, May, August and November
Series K	Not Listed	—	First business day preceding payment date	The day after the third Wednesday of every month
Series M	BPP.PR.M	Toronto	Last business day of January, April, July and October	Fourteenth day of February, May, August and November
Series N	Not Listed	—	Six business days preceding payment date	The day after the third Wednesday of every month

* *All dividends are subject to declaration by the company's Board of Directors.*

Directors and Officers

Directors

Robert J. Harding, F.C.A.
Toronto, Ontario
Chairman, BPO Properties Ltd. and
Chairman, Brascan Corporation

Richard B. Clark
New York, New York
President and Chief Executive Officer
Brookfield Properties Corporation

The Hon. William G. Davis, P.C., C.C., Q.C.
Toronto, Ontario
Counsel
Torys

Robert J. McGavin
Aurora, Ontario
Corporate Director

Michael F.B. Nesbitt
Winnipeg, Manitoba
Chairman
Montrose Mortgage Corporation Ltd.

Officers

Thomas F. Farley
President and Chief Executive Officer

Craig J. Laurie
Senior Vice President and
Chief Financial Officer

Kathleen G. Kane
Senior Vice President and Secretary

Rael L. Diamond
Vice President and Controller

Brett M. Fox
Vice President and Assistant Secretary

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Shareholder questions relating to dividends, address changes and share certificates should be directed to the CIBC Mellon Trust Company.

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Annual General Meeting

The Annual General Meeting of shareholders will be held in Toronto at the Hockey Hall of Fame, BCE Place, 30 Yonge Street, Toronto, Ontario, at 1:30 p.m. on May 19, 2004. Shareholders may also participate by webcast through BPO Properties' Web site at www.bpoproperties.com.

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